Course Syllabus

Description of topics: The course begins by asking how are exchange rates and financial markets related – by arbitrage and by equilibrium pricing relationships, and how can foreign exchange risk be hedged. Then the focus shifts to longer-term issues of international corporate finance. Key corporate financial issues are explored including exchange rate exposure, taxation, securities pricing, the cost of capital, and the evaluation of foreign projects.

Prerequisites: A thorough knowledge of FNCE 601/100 is assumed.

Reading material: A bulk-pack is available online.

Text: Class notes prepared by Prof. Karen Lewis provide an invaluable introduction to many of the topics in the course. These class notes are available on the web café. There is no textbook in the course. For later topics in the course not covered by Prof. Lewis’s notes, there are chapters taken from textbooks included in the bulkpack.

Cases: There are five cases, two mini cases, and four problem sets/exercises that will be discussed in class. Students must form case study groups of 3 to 5 students to prepare the cases and other assignments. All team members are responsible for these assignments. Every student in the group must retain a copy of the write-up and bring it to the class where the case or problem set is discussed. Assignments are due at the beginning of class. If group members attend different classes, the assignment must be submitted in the earlier class.

Grading: You must submit all of the cases and exercises. The exams are also mandatory.

The final grade will be awarded as follows:
- Exams: 65%
- Cases and problem sets: 30%
- Class participation: 5%
A numerical weighted average will be computed. The numerical grade distribution will dictate the final grade, according to the faculty's recommended grade distribution.

**Important Notice:** There will be two mid-term exams on the following dates:

- **Wednesday, October 20th** (in class)
- **Wednesday, December 1st** (in class)

Please make a note of these dates. There will be no specific makeup exams for these exams. If either exam is missed, it is necessary to take a makeup exam covering the entire course to be given at the beginning of the spring term. **There will not be a final exam in the course.**

**Exam policy:**
In the exams, students will be allowed to bring in a one-page “formula sheet”. Calculators will also be needed. Exams may (almost surely will) contain questions regarding cases. There will be a review session before each exam.

**Course Topics**

**Note:** For dates of each class and due dates for assignments, see the course schedule.

**FIRST HALF**

**Classes 1-3. Short-run exchange rate behavior: interest parity and expectations**

Notes by Prof. Karen Lewis (Lewis notes), Section I, “Introduction to Foreign Exchange and Eurocurrency Markets”
Lewis notes, Section II, “Understanding Exchange Rate Behavior: Interest Rate Parity”

**Assignments (due in later classes – see schedule):**
Problem set on Arbitrage

**Classes 4 and 5: Long-run exchange-rate behavior: PPP and Real exchange rates**

Lewis notes, Section VI, “PPP and Real Exchange Rate Risk”

**Assignment (due in later classes – see schedule):**
Case 1: Cemex: Cross-Currency Debt and Exchange Risk (Thunderbird)
Classes 6 and 7: Hedging I: Hedging with Forwards and Options

Lewis notes, Section III, “Forwards: Hedging”
Lewis notes, Section IV, “Hedging Part 1: Foreign Exchange Options”
Lewis notes, Section VIII, “Foreign Exchange Options,” pages 168-182
“1998 Survey of Derivatives Usage by U.S. Non-Financial Firms”

Assignment: Problem set on Hedging (due later – see schedule)
Case 2: Tiffany – 1993 (HBS) Instructions will be distributed in class

Classes 8, 9, and 10. Hedging II: Multi-year cash flows and hedge ratios

Lewis notes, Section V, “Hedging Part 2: Hedge Ratios”

Assignment: Problem set on Hedge Ratios (due later – see schedule)

EXAM # 1 (Wednesday, October 20th in class)

Special Topics: In addition to the assigned topics listed, there will be special topics introduced when time is available.

Special Topic 1: The “Euro”
Special Topic 2: Mexican Devaluation of December 1994
Special Topic 3: Future of the Dollar
Special Topic 4: Argentina and Brazil
Special Topic 5: The “Greek” crisis

SECOND HALF

Classes 12 and 13: Foreign Exchange Exposure

Lewis notes, Section VII, “Exchange Rate Exposure”

Adler and Dumas, “Exposure to Currency Risk: Definition and Measurement”,

Bodnar and Marston, “A Simple Model of Foreign Exchange Exposure”, in
pp. 275-286.

Assignment (due in a later class – see schedule):
Case Study 3: Jaguar plc - 1984
Case Study 4: Tektronix (C) (Thunderbird)
Class 14 and 15: International Financing

Lewis notes, Section IX, “Foreign Currency Bonds,”
Lewis notes, Section XI, Syndicated Loans, except Sections C and D


**Assignment:** Mini-case – Tirstrup
Mini-case – Semen Indonesia’s Financing

Class 16: International Equity Markets

Lewis notes, Section XII, “International Portfolio Choice and Equity Markets”


Class 17 and 18: Cost of Capital for International Investments


**Assignment:** Case Study 6: GM Plant X Brazil
Partial submission – (see instructions for case and schedule)

Class 19 and 20: Capital Budgeting for International Investments

“Note on Adjusted Present Value”, HBS 9-293-092, October 1994


Assignment:
Case Study 6: GM Plant X – Brazil (rest of case - see schedule)

Class 21: International Taxation


Assignment: Case Study 6: GM Case – Part 2: Cost of capital and valuation of project

EXAM # 2 (Wednesday, December 1st in class)

Class 23: Special Topics

Class 24: Discussion of GM Plant X - Brazil

Class 25: Political Risk (Electronic class -- to be completed before 2nd midterm)